

**U.S. Bankruptcy Court
Eastern District of Michigan (Detroit)
Bankruptcy Petition #: 13-53846-swr**

Date filed: 07/18/2013

Assigned to: Judge Steven W. Rhodes
Chapter 9
Voluntary
No asset

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WAYNE-MI
Tax ID / EIN: 38-6004606

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
TRANSCRIPT ORDER FORM

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Case/Debtor Name:

Case Number: 13-53846

Chapter: 9

Hearing Judge Hon. Steven Rhodes

☒ Bankruptcy ☐ Adversary

☐ Appeal Appeal No: _____

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Date of Hearing: 10/21/2013 Time of Hearing: 1:00 p.m. Title of Hearing: Eligibility Hearing

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

IN RE: CITY OF DETROIT, . Docket No. 13-53846
MICHIGAN, .
. Detroit, Michigan
. October 21, 2013
Debtor. . 1:00 p.m.
.

HEARING RE. OBJECTIONS TO ELIGIBILITY TO CHAPTER 9
PETITION (CONTINUED)
BEFORE THE HONORABLE STEVEN W. RHODES
UNITED STATES BANKRUPTCY COURT JUDGE

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1 THE CLERK: All rise. Court is in session. Please
2 be seated. Recalling Case Number 13-53846, City of Detroit,
3 Michigan.

4 THE COURT: And you may proceed.

5 MR. GORDON: Thank you, your Honor. Good afternoon.
6 For the record, Robert Gordon of Clark Hill on behalf of the
7 Detroit Retirement Systems. Your Honor, we did not submit a
8 proposed line-up to the Court as we did for the October 15th
9 hearing; however, the objectors have all conferred with one
10 another over the weekend and have come up with an informal
11 line-up, if you will, and have discussed amongst themselves
12 sort of loosely how much time each party would need. And so
13 rather than inform the Court of the time slots, we'll just
14 sort of try to self-police ourselves and inform the Court if
15 that's okay.

16 THE COURT: Okay.

17 MR. GORDON: Again, as with the October 15th
18 hearing, each party will try its best to identify before it
19 starts its rebuttal argument -- apprise the Court of what
20 issues it plans to touch upon. Unlike the October 15th
21 hearing, of course, because time is short, various parties
22 will be trying to touch upon discrete issues and not overlap
23 with one another, so while each party may support the
24 arguments that are being made, for the record, I just need to
25 state that each party obviously reserves its right to make

1 similar arguments or diverge from those arguments in its
2 supplemental briefing. Thank you.

3 With that, your Honor, just so the Court has an
4 understanding of the order in which we are proposing the
5 objectors rise, first would be Ms. Levine on behalf of
6 AFSCME, then Ms. Brimer on behalf of the Retired Detroit
7 Police Members Association, then myself on behalf of the
8 Retirement Systems, then Mr. Morris on behalf of the Retiree
9 Associations, then Ms. Patek on behalf of the Public Safety
10 Unions, then Ms. Crittendon as an interested party, and then
11 Mr. Montgomery on behalf of the Retiree Committee.

12 THE COURT: All right.

13 MR. GORDON: Oh, my goodness. I'm sorry. After --
14 I'm sorry. After Mr. Morris, Ms. Ceccotti would be next on
15 behalf of the UAW.

16 THE COURT: Thank you. It's fine with me not to
17 keep track of your time individually if that's your request,
18 but I do have to cut off all rebuttal argument in one hour.

19 MR. GORDON: Very well, your Honor. Thank you.

20 THE COURT: And one more thing. You will notice
21 that on your tables we now have three microphones instead of
22 one. I have been asked to advise you that this makes it much
23 more likely that our record will pick up your private
24 conversations, and you should be concerned about that because
25 we do post the audio unedited on our website every night.

1 And I should say if there is a private conversation that you
2 want to have at any point today or during the trial and
3 you're concerned about it getting on the microphone, just
4 request a brief pause from the recording. We'll turn the
5 recording off. You can have your conversation, and we'll
6 continue.

7 MS. LEVINE: Good afternoon, your Honor. Sharon
8 Levine, Lowenstein Sandler, for AFSCME. Your Honor, I've
9 been given ten or twelve minutes and will address, per the
10 Court's suggestion, home rule and then perhaps if there's
11 time a sentence on Chapter 9 again.

12 THE COURT: Okay.

13 MS. LEVINE: Thank you, your Honor. Your Honor,
14 similar to the arguments or the statements in the
15 conversation we had with the Court with regard to Chapter 9
16 and the interplay between the federal Constitution and the
17 state municipal governments under the Tenth Amendment, we
18 would respectfully submit that under the Cooley Doctrine and
19 the cases that have been decided here in Michigan that the
20 Michigan Constitution in Chapter 7 also reflects a very
21 strong view towards home rule, and what we mean by home rule,
22 your Honor, is that the local governments -- in this case,
23 Detroit -- are given a lot of respect by the state government
24 in order to manage and run their own local governments. And
25 we would respectfully submit that the way that either 439 is

1 written or as applied in this case, that the grant of power
2 given the emergency manager here in Detroit violates the
3 state Constitution.

4 So, first, your Honor, we would note that the
5 emergency manager has been appointed by the state. He was
6 not elected by the local electorate. He was not elected the
7 way, for example, the mayor and the City Council were
8 elected. He has supplanted them, and he was -- and he didn't
9 supplant them by a vote of the citizens, and he didn't even
10 supplant them with the consent of the locally elected
11 officials. So first point is that we believe that the
12 emergency manager and 436 is inappropriate here because he's
13 not an elected official.

14 Two, your Honor, we would note that the breadth of
15 the powers granted the emergency manager even if the
16 appointment of the emergency manager were appropriate is
17 inappropriate here both as a matter of constitutional law and
18 as applied in this particular case because the governor
19 failed to appoint the emergency manager with any appropriate
20 contingencies in the letter of appointment, and that's
21 because of the scope of the power that the emergency manager
22 wields is well in excess of that which the Constitution --
23 the Michigan Constitution would permit. So, for example,
24 even if the scope of the powers were not subject to -- sorry.
25 Let me say it differently. Even if the Michigan Constitution

1 does allow, for example, taxation or even debt adjustment, it
2 doesn't allow the wholesale taking over of the local
3 government by the emergency manager. So, for example, not
4 allowing there to be replacements to the City Council, day-
5 to-day negotiation of vendor contracts, labor contracts,
6 grievances, de minimis asset sales, these are the types of
7 things that are not necessarily --

8 THE COURT: Well, but let me ask you to -- let me
9 ask you to pause there with this question. Is the
10 constitution -- or would the constitutionality of PA 436, as
11 it pertains to those kinds of issues, be before this Court?
12 Are they necessary to decide in the context of eligibility?

13 MS. LEVINE: They are, your Honor, because the way
14 this appointment has taken place, all of those individual
15 acts that the emergency manager has been allowed to engage in
16 ahead of a plan of adjustment which might deal with just the
17 debt makes the very decision that the emergency manager made
18 with regard to filing the Chapter 9 petition itself
19 unconstitutional or unconstitutional as applied to the facts
20 of this case because there was no limitation on what the
21 scope of his authority was just dealing with that one issue.
22 And that scope -- the unfettered scope, your Honor, is not
23 just related to the day-to-day business operations, and we've
24 seen that play out in the deposition of Mayor Bing and in
25 others who talk about the fact that they're bottlenecked with

1 regard to decision-making and that ordinary types of
2 decision-making is now deferred to the emergency manager or
3 his counsel, but we've seen that, your Honor, in the
4 unfettered scope that provides for no judicial review of
5 those decisions as well. So, for example, if, in fact,
6 there's a dispute under a Chapter 11 or a Chapter 7 where you
7 have a debtor in possession or a trustee, a debtor in
8 possession, for example, a corporate debtor, has fiduciary
9 obligations under the direct language of the Bankruptcy Code
10 and has fiduciary obligations under state law. A Chapter 7
11 or a Chapter 11 trustee similarly has fiduciary obligations,
12 and they are not allowed to take actions either outside the
13 ordinary course of business or under the course of a Chapter
14 7 without coming to this Court for approval, sales,
15 settlements, ultimate plans of reorganization. Under Chapter
16 9, because we're dealing with the fact -- and we believe it's
17 the unconstitutional fact -- that there's a tension between
18 what the state can do and what the federal government can do,
19 we don't have that same access to judicial review, so under
20 904, 362, and even Stern's there are a lot of decisions that
21 get made on the day-to-day basis. And I'm not dealing with
22 the global jurisdictional issues, just the day-to-day basis
23 of tort claims, of contract disputes, of settlements with
24 individual creditors that don't ever see the light of day in
25 this court, and to the extent that there was a grievance or a

1 dispute about that under 362 in this Court's stay extension
2 orders, there's no other court where those disputes can be
3 taken.

4 So we have an unelected emergency manager who's in
5 place now because he's a contractor with the state
6 government, and we have unfettered rights where basically our
7 view is it's tantamount to all of the rights that were
8 granted to the city under Chapter -- under Article VII of the
9 Constitution are now within the power of the EM in this
10 particular case. And we'd respectfully submit that that is
11 just not what the Cooley Doctrine or the state Constitution
12 envisioned even if it did envision in appropriate
13 circumstances debt restructuring.

14 Nine minutes. With that, your Honor, I would just
15 close briefly on Chapter 9. We would respectfully submit
16 that similar -- well, I'll --

17 THE COURT: I'm not sure you've quite addressed the
18 central home rule question that at least I see. The city and
19 the state argue that to whatever extent home rule powers
20 apply to the City of Detroit under the Michigan statutes,
21 they are effectively modified by PA 436 and that that
22 modification is not inconsistent with whatever the Michigan
23 Constitution says about home rule. How do you deal with
24 that?

25 MS. LEVINE: Your Honor, we understand the statement

1 has been made along those lines. We don't see those
2 modifications in PA 436. In other words, either in the
3 statute itself or in the authorization as granted under the
4 statute here, there is no limitation that we can see, and, in
5 fact, we've seen the opposite through the emergency manager's
6 orders and the emergency manager's right to run unfettered
7 the City of Detroit. And in addition to that, one of the
8 issues that they talk about in terms of limiting his ability
9 is that his term is only 18 months, but that also is not
10 supported if you take a look at the statute and you take a
11 look at the statute in practice without any limitation in the
12 authorization because at the end of 18 months, the state has
13 the absolute right to continue the term. The City Council
14 can only stop that by a two-thirds vote, but since the EM has
15 effectively taken over the City Council, we don't even have
16 the checks and balances that appear facially on the statute,
17 so we're saying two things. We're saying they can say that
18 it's a limitation, but as far as we can tell, PA 436
19 virtually gives away to the emergency manager everything that
20 was referred to the states under Chapter 7 of the
21 Constitution, and not only that, there is no redress for
22 addressing violations of that unfettered right or stopping
23 the time line pursuant to which the EM can stay in office.
24 Thank you.

25 MS. BRIMER: Good afternoon, your Honor. Lynn M.

1 Brimer appearing on behalf of the Retired Detroit Police
2 Members Association. Your Honor, to begin with, I have
3 approximately ten to twelve minutes of the allotted time for
4 the objectors. I am going to discuss, your Honor, the narrow
5 issue of whether or not PA 436 is constitutional under the
6 referendum provision of the Michigan Constitution. As your
7 Honor will recall, Article II, Section 9, of the Michigan
8 Constitution specifically reserves to the people of Michigan
9 the right of referendum with respect to any law other than
10 those that contain a spending or appropriation provision.

11 When we were here on Tuesday, your Honor, last week,
12 I advised the Court that at that time the city and the state
13 neither had responded to the arguments that had been raised
14 by the RDPMA in its opening objection and, moreover, that at
15 that point in time we had not been able to find a case that
16 was factually similar to this case. Today, we do have the
17 oral arguments that were presented by Ms. Nelson in response
18 to this argument during the state's opening arguments. The
19 city has still not responded to this discussion, and we
20 still, your Honor, do not have a case that is even closely
21 factually similar to this case.

22 As the Court may recall, Ms. Nelson cited the case
23 of Reynolds v. Martin for the proposition that the governor
24 and the state legislature can completely disregard the will
25 of the people and thwart the people's constitutional right to

1 a referendum by placing an insignificant spending provision
2 at the tail end of an act that had previously been defeated
3 on referendum, pass such act during a lame duck session, and
4 consider it to be constitutional. Reynolds v. Martin is so
5 factually distinguishable, your Honor, as to be of little or
6 no actual application to this case, and ultimately we would
7 conclude that its holding, in fact, supports the argument of
8 the RDPMA. And I think it's very important to very briefly
9 discuss that case. In Reynolds in 1994 the legislature
10 passed an act amending the state's Bingo Act. That act was
11 referred for referendum. However, before it was placed on
12 the 1994 ballot, certain of its signatures were questioned.
13 Therefore, it did not make the 1994 ballot. The general
14 election was held in November of '94. A new legislation --
15 legislators were elected. They were seated in 1995. In 1995
16 with the new legislation in -- legislative body in place, a
17 new act was passed. Subsequently, in 1996 the 1994 act was
18 certified for the referendum, and it was, in fact, voted down
19 in the referendum.

20 A party challenged the denial of a license under the
21 1995 act on the grounds that it could not have been passed in
22 contravention of the referral of the 1994 act to the
23 referendum process under Article II, Section 9. However,
24 your Honor -- and ultimately the 1995 act was upheld as
25 constitutional.

1 The state would argue that that case is factually
2 applicable and the holding consistent with their position
3 that PA 436 is constitutional. However, there are two
4 significant distinctions between the holding and the facts in
5 Reynolds and the matter before this Court with respect to
6 436. One, there was a general election after the matter had
7 been referred to referendum. A new legislative body was in
8 place, and it was the new legislative body that had been, in
9 fact -- that passed the new act. But more significantly,
10 your Honor, the 1995 act did not contain a spending
11 provision, and it was not, therefore, removed from the
12 referendum provisions of the Michigan Constitution. In fact,
13 in Reynolds the appellate court relied on the Michigan
14 Supreme Court holding in Michigan Farm Bureau versus
15 Secretary of State at 379 Mich. 387, 1997, and noted that
16 should the legislators not be responsive to the will of the
17 people expressed at the referendum vote, the second
18 legislation itself is subject to the same right of referendum
19 as the original act. That is simply not what we have with
20 respect to 436.

21 The question, your Honor, is why wasn't 436 subject
22 to the referendum vote? It was not subject to the referendum
23 vote because the governor, the Michigan Department of
24 Treasury, and their consultants devised a scheme in the event
25 that PA 4 was defeated on referendum, that would remove a new

1 law from the referendum. And how do we know that there was a
2 scheme that was devised? We have communications that have
3 been produced during discovery that confirm that the spending
4 provisions in Section 34 and 35 were included in order to
5 avoid the referendum vote. For example, as early as March
6 2nd, 2012, in communications between Mr. Ellman at Jones Day
7 and Ms. Ball at Jones Day, Mr. Ellman was discussing the
8 possibility that PA 4 would be defeated on referendum and
9 what the options would be in the event it was rejected by the
10 people. He states in discussing the options, your Honor,
11 "The cleanest way to do all of this probably is new
12 legislation that establishes the board and its powers and" --
13 with the "and" in capital letters, your Honor -- "includes an
14 appropriation for the state institution. If an appropriation
15 is attached to, parenthetical, included in the statute to
16 fund a state institution, parenthetical, which is broadly
17 defined, then the statute is not subject to repeal by the
18 referendum process."

19 In fact, Mr. Orr himself has acknowledged this
20 concern with respect to PA 436. On January 31st, 2013, he e-
21 mailed Ms. Ball stating the following: "Michigan's new EM
22 law is a clear end-around the prior initiative that was
23 rejected by the voters in November." He then discusses some
24 of the provisions of PA 436 and concludes with the following
25 statement: "So although the new law provides the thin veneer

1 of a revision, it is essentially a redo of the prior rejected
2 law." Your Honor --

3 THE COURT: What was the date of that?

4 MS. BRIMER: That, your Honor, was January 31st,
5 2013. So, your Honor, despite Ms. Nelson's contention that
6 the spending provisions were not added in an effort to avoid
7 the referendum vote, we would suggest that the evidence and
8 the discovery proves otherwise.

9 Ms. Nelson also argued that the \$5,780,000 spending
10 provisions were meaning provisions not designed to avoid the
11 referendum. First, I would suggest quite to the contrary,
12 your Honor. A review of the state's financial statements for
13 the fiscal year ending 9-30, 2012, suggests that \$5,780,000
14 represents approximately .011 percent of the state's
15 expenditures for the prior fiscal year. With respect to the
16 pensioners that are before this Court making an average of
17 \$18,000 in their pension, that would represent \$1.98. I
18 would suggest that's hardly a meaningful spending provision.

19 But second and more significant is that we have the
20 words of the debtor's attorney in the e-mails that I read to
21 you that the spending provisions were added with the intent
22 of avoiding the referendum. We also have testimony from the
23 state's 30(b)(6) witness, Howard Ryan, the legislative
24 liaison for the Department of Treasury during the period for
25 the drafting of 436, in which he testified in his deposition

1 on October 14th that the spending provisions were added to
2 avoid the referendum.

3 "Question: Based on your conversations with the
4 people at the time, was it your understanding that
5 one or more of the reasons to put the appropriation
6 language in there was to make sure it could not --
7 that the new act could not be defeated by
8 referendum?

9 Answer: Yes.

10 Question: Where did you get that knowledge
11 from?

12 Answer: Well, having watched the entire process
13 unfold over the past two years.

14 Question: The governor's office knew that that
15 was the point of it?

16 Answer: Yes."

17 Your Honor, we would suggest that those spending
18 provisions were, one, de minimis, and, two, added solely for
19 the purpose of removing this act from the constitutional
20 right of the people to a referendum vote.

21 I'm uncomfortable with the amount of time I have
22 left here, your Honor. Two more points. Ms. Nelson argued
23 that PA 436 has substantially changed PA 4. We prepared a
24 comparative analysis, your Honor, of the relevant provisions,
25 those with respect to the appointment of an emergency manager

1 and those with respect to the authorization for the filing of
2 a Chapter 9. Those provisions are virtually identical. Our
3 comparative analysis has been attached and submitted to the
4 Court as Exhibit B to our pretrial brief. Those provisions
5 were, in fact, your Honor, subject to the provision in the
6 Constitution which provides that no law as to which the power
7 of referendum properly has been invoked shall be effective
8 thereafter unless approved by a majority of the electors
9 voting thereon in the next general election.

10 Your Honor, the Michigan Supreme Court, which should
11 be our controlling court here, has, in fact, suggested that
12 the right of referendum is so important to this state and so
13 important to our constitutional rights that in Kuhn -- I'm
14 trying so hard to get through my time -- that in the matter
15 of Kuhn v. Department of Treasury the Court said that this is
16 a reserved right to the people which must be liberally
17 construed. This Court must liberally construe the right of
18 the people to the referendum, find that the Michigan Supreme
19 Court would, in fact, determine that PA 436 violates Article
20 II, Section 9, of the Michigan Constitution, and, therefore,
21 cannot have been a proper basis for authorization of the
22 filing of this Chapter 9 under Section 109(c) of the
23 Bankruptcy Code.

24 THE COURT: Thank you.

25 MR. GORDON: Again, for the record, Robert Gordon of

1 Clark Hill. Your Honor, I want to touch upon, if I may, an
2 issue that was raised on the 15th regarding who is
3 essentially the impairer of contracts in a Chapter 9 process
4 and then touch upon one other small matter that came up in
5 colloquy on that day.

6 Your Honor, during the oral argument, city's counsel
7 argued that in a Chapter 9 case, the law views the federal
8 government as the sole relevant actor impairing contracts of
9 the debtor municipality and that, therefore, the prohibition
10 in the pensions clause against the state and its subdivisions
11 impairing accrued pension benefits is of no moment in this
12 matter because it will be the federal government and not the
13 state or the city that is doing the impairing.

14 In making the argument, the city's counsel relies on
15 the language of a dissenting opinion of Justice Cardozo in
16 the Ashton case and then suggests that the viewpoint
17 expressed therein is adopted by the Bekins court, which
18 overruled Ashton. We submit that the analysis is incorrect.
19 First, it is not entirely clear that the expansive
20 interpretation of Justice Cardozo's opinion suggested by the
21 city comports with his intended meaning. However, even if
22 that interpretation is accurate, there is no indication that
23 his views were adopted in Bekins, a decision in which Justice
24 Cardozo did not even participate.

25 Contrary to the city's argument, as we've pointed

1 out in our papers, it is the municipality alone that can file
2 a plan and propose the impairment of claims, and it is the
3 municipality alone that can solicit votes and ask the Court
4 to approve such a plan. Indeed, your Honor, the reality of
5 the active role played by the debtor is reflected clearly in
6 Section 109 itself. 109(c)(5) provides, and I quote, "(a) An
7 entity may" -- excuse me. It provides under 109(c), I quote,
8 "An entity may be a debtor under Chapter 9 of this title if
9 and only if such entity," and then under (5)(A) it says, "has
10 obtained the agreement of creditors holding at least a
11 majority in amount of the claims of each class that such
12 entity intends to impair under a plan in a case under such
13 chapter," and there's similar language under 109(c)(5)(B).
14 Both of those provisions talk about the municipal debtor
15 being the one who intends to impair under the plan. It
16 doesn't say that the municipal entity intends to ask the
17 Court to impair. So 109(c)(5) reflects the reality that we
18 just discussed.

19 Moreover, contrary to the city's argument, your
20 Honor, Chapter 9 jurisdiction turns on the basic concept that
21 the state can consent to subjecting a political subdivision
22 to federal bankruptcy law. Having thus consented, federal
23 law will then apply, but it is still the state and its local
24 governmental unit that is actively availing itself of the
25 Bankruptcy Code in the Bankruptcy Court. The city has not

1 and we submit cannot cite to any case law that describes a
2 Chapter 9 debtor as standing mute and passive in the
3 Bankruptcy Court during the plan process and simply accepting
4 whatever impairment of contracts the Court may mete out.
5 It's an unsupportable and unsupported proposition, we submit.

6 Since the state and its political subdivision is
7 clearly the impairer of contracts in the Chapter 9, then
8 absent the relief that's been requested by the Retirement
9 Systems and other objectors, the state or the city in this
10 case would be directly breaching the pensions clause, which
11 it cannot do. To the extent it is asking the federal court
12 to assist, it cannot do so since the state government and its
13 subdivisions are bound by the pensions clause and cannot
14 delegate to another entity authority that they do not have to
15 abrogate Michigan's Constitution. And we've cited several
16 cases in our reply brief at page 15 for the axiom that the
17 state and its various branches cannot do indirectly what they
18 cannot do directly.

19 Since the state and the city cannot violate the
20 Michigan Constitution and specifically the pensions clause
21 outside of the Chapter 9 process, they can no more do so in
22 Chapter 9, and the requirement that the Retirement Systems
23 and other objectors have advocated for -- i.e., an explicit
24 conditioning of the bankruptcy upon the protection of the
25 pensions clause -- is absolutely proper and mandated by

1 Section 109(c)(2)'s respect for state law. Any other
2 conclusion we submit eviscerates 109(c)(2) and its
3 requirement to uphold the Tenth Amendment and the sovereignty
4 of state law. Moreover, your Honor, there was --

5 THE COURT: So is the end result of that argument
6 that no municipality in Michigan can file a Chapter 9?

7 MR. GORDON: The end result would be that they
8 cannot file a Chapter 9 without the explicit understanding
9 that they will not impair accrued pension benefits in
10 violation of the pension clause.

11 THE COURT: Well, but that violates the Bankruptcy
12 Code.

13 MR. GORDON: How so, your Honor?

14 THE COURT: Well, it gives a priority to one
15 unsecured creditor over all the others, or one group of
16 unsecured creditor over all the others.

17 MR. GORDON: We disagree, but the priority issue I'm
18 going to defer to Mr. Morris on. He was going to speak about
19 that issue, but we disagree that it can be characterized as a
20 priority issue, your Honor. I just don't want to steal his
21 portion.

22 THE COURT: Okay.

23 MR. GORDON: But it is not a priority --

24 THE COURT: No pressure, Mr. Morris.

25 MR. GORDON: It is not a priority issue, your Honor.

1 Moreover, your Honor, the city's counsel had suggested, I
2 believe, on October 15th that Section 943(b) may not contain
3 any bar to adjusting debts but only technical restrictions on
4 how debt adjustment may be implemented. If he is correct --
5 and we think not -- then all the more reason why the
6 protection of pension benefits under the pensions clause must
7 be addressed at the eligibility stage.

8 The only other thing, your Honor, I wanted to touch
9 upon was at, I think, page 103 of the written transcript of
10 the hearing on the 15th we had a discussion in which I
11 likened the accrued pension benefits to a nondischargeable
12 debt, and the Court questioned whether that concept was truly
13 applicable in a Chapter 9. I wish to simply note to the
14 Court that while Section 523 of the Bankruptcy Code was not
15 incorporated into Chapter 9, Section 944(c) provides that the
16 debtor is not discharged under Subsection (b) of this section
17 from any debt excepted from discharge by the plan or order
18 confirming the plan. So, indeed, concepts of
19 nondischargeable debt do exist under Chapter 9 of the
20 Bankruptcy Code, and because it is not governed by Section
21 523 of the Bankruptcy Code, it must be assumed -- because
22 there's no other basis identified in the Bankruptcy Code
23 itself, it must assumed that the bases for
24 nondischargeability would arise under state law such as the
25 absolute and impermeable protection of accrued pension

1 benefits under the state's Constitution.

2 THE COURT: Why isn't it safer to assume that that
3 provision is in there to facilitate parties' negotiations
4 regarding how to treat debts?

5 MR. GORDON: I don't know that it's mutually
6 exclusive. It could be nondischargeability. It could be as
7 a matter of law --

8 THE COURT: Okay.

9 MR. GORDON: -- or by negotiation, your Honor.

10 THE COURT: Okay.

11 MR. GORDON: We would simply submit that with
12 respect to a state constitutional protection, it can't be the
13 subject of negotiation. Thank you, your Honor.

14 THE COURT: Okay.

15 MR. MORRIS: Good afternoon, your Honor. Thomas
16 Morris on behalf of the Retiree Association parties. There
17 was discussion last week and, in fact, this morning, today,
18 this afternoon, regarding the manner in which the pensions
19 clause operates. Specifically, there were comments by Mr.
20 Bennett which characterize the pensions clause as
21 establishing a payment priority. Mr. Bennett would have the
22 Court view the pensions clause as the equivalent of a state
23 law which designates a public pension obligation as a
24 priority claim in bankruptcy. This is an incorrect
25 characterization of the pensions clause.

1 The pensions clause is a state law which controls
2 the city in the exercise of its political or governmental
3 power. The pensions clause establishes a constitutional and,
4 therefore, fundamental rule addressing the authority of a
5 municipality to reduce or impair its pension obligations. It
6 is an essential definition of the state -- of the duties of
7 the state and its subdivisions. The pensions clause simply
8 doesn't provide for a priority payment. The usual way for a
9 state to provide for a priority is to specify that the debt
10 is entitled to priority. An example is found in the Worker's
11 Compensation Disability Act, MCL 418.821, which provides that
12 liability of an employer for Worker's Compensation claims or
13 Worker's Compensation payments shall be paramount to other
14 claims except for wages and taxes. Another way to ensure a
15 priority is to provide for a statutory lien, so we've got
16 lien -- a lien under Section 211.40 of the Michigan Compiled
17 Laws for property taxes that are secured by a first lien,
18 prior, superior, and paramount. And MCL 324.3115 provides
19 that certain fines for environmental liabilities constitute a
20 lien on all property of any kind or nature owned by the
21 defendant. And a construction lien is entitled to priority
22 under state law.

23 In Orange County -- in the case if Orange County
24 found at 151 B.R., there's a quote on page 1017. In Orange
25 County there was a statute at issue, a California statute

1 that was found by the Orange County court to be preempted by
2 the Bankruptcy Code. Now, that statute provided that --
3 provided for certain funds to be treated as trust funds, and
4 that statute, as interpreted by the Court, apparently or was
5 argued to provide for there to be no tracing requirement, so
6 the Court in that case found that statute to effectively
7 establish a priority in bankruptcy and found it to be
8 preempted. That case is distinguishable. The Michigan
9 pensions clause provides for no priority of payment. It
10 simply provides an ongoing indestructible duty of the
11 municipality or the state to not impair and not reduce
12 pensions.

13 Now, the priorities provided for in Section 507 are
14 applicable in Chapter 7 cases, for example, because Chapter 7
15 is a process of liquidation, liquidation of assets and the
16 distribution of those assets, so you need to determine who's
17 going to get the assets. Who gets paid first? That's the
18 priority. Those priorities are also applicable in Chapter 11
19 because in every Chapter 11 case, liquidation is an
20 alternative. Liquidation is the implied alternative, and
21 it's a standard by which a plan of reorganization in a
22 Chapter 11 case is measured. Liquidation is not provided for
23 in Chapter 9. Therefore, priorities are not provided for in
24 Chapter 9 with one exception. That one exception is
25 507(a)(2), which provides for administrative expense

1 priorities. That's a --

2 THE COURT: But doesn't the best interest test of
3 943(b)(7) implicate the priorities of the Bankruptcy Code?

4 MR. MORRIS: It doesn't. It doesn't implicate the
5 priorities of a liquidation as an alternative unlike in
6 Chapter 11. That's what's done -- in a Chapter 11 you look
7 at the unsecured creditors. What would they get in
8 liquidation?

9 THE COURT: Your position is that there's nothing in
10 a municipal bankruptcy case that would prohibit one group of
11 unsecured creditors from insisting on payment before or in
12 full while other unsecured creditors are paid later or not in
13 full.

14 MR. MORRIS: Well, in confirmation of a case where
15 the pensions are unimpaired, you have a possible
16 discrimination claim by other creditors. The bondholders
17 might claim that it's unfair discrimination, and I think the
18 response would be any bondholders who purchased their bonds
19 prior to 1963 when the Michigan Constitution was adopted,
20 you've got a different argument, but those bondholders who
21 purchased their bonds after 1963, which is all of them, don't
22 have an argument. They're aware of the political climate.
23 They're aware of the Constitution. They're aware that the
24 municipality cannot --

25 THE COURT: Right, but the city's response to that

1 is the people who lobbied for and got the pensions clause in
2 the Constitution were aware of the Chapter 9 possibility.
3 How do I deal with that, or how do you deal with that?

4 MR. MORRIS: Mr. Gordon dealt with that.

5 THE COURT: Okay. I will look at what he said.

6 MR. MORRIS: But I don't want to -- I don't want to
7 repeat it, but the city is not permitted to restrict or
8 impair the pensions. They are an inviolate obligation that
9 the city will live with even if it reorganizes under Chapter
10 9. That's just a fact. If the City of Detroit were to cease
11 to exist, if there were to be some horrendous natural
12 catastrophe that wiped the city off the state -- wiped the
13 city off the map, then we believe the city would still owe
14 that obligation, and it might cause a constitutional crisis.
15 Maybe the state would have to -- let's say the city remained
16 with only one resident, and that one resident couldn't
17 possibly pay the taxes to pay this. It would cause a
18 constitutional crisis. There'd have to be a resolution.
19 Maybe the state would step in. I don't know. That's beyond
20 conjecture.

21 THE COURT: The city says we're there now. I'm
22 sensing from Ms. Ceccotti having risen that your time may be
23 up.

24 MR. MORRIS: Yes, it is. Thank you.

25 MS. CECCOTTI: Your Honor, I actually rose because I

1 was planning to address the question that you just asked --

2 THE COURT: Okay.

3 MS. CECCOTTI: -- about -- and I was going to
4 actually spend less time on it, but I think I'll just
5 dispense with -- I was going to -- first of all, for the
6 record, Babette Ceccotti, Cohen, Weiss & Simon, LLP, for the
7 UAW, and good afternoon again.

8 I was going to spend some time on talking about the
9 pension clause, the language of the pension clause, and how
10 the courts in Michigan address constitutional provisions when
11 called upon to review them and the principles that they
12 apply, but I'm going to move actually right to your Honor's
13 question because I do think that a lot of -- some of the
14 questions that your Honor has asked, particularly this
15 afternoon, really do go to what I think is going to be the
16 crux of this.

17 First of all, on the city's point that the pension
18 clause doesn't seem to make any -- doesn't, in fact, make any
19 reference to the possibility of municipal bankruptcy, I think
20 we have to go and ask ourselves a couple of questions.
21 First, what did municipal bankruptcy mean at the time, and
22 what did pension rights mean at the time? And so we have to,
23 you know, sort of bring ourselves back in the legal regime --
24 in two legal regimes to 1963. First, the city's brief cites
25 to a law that was on the books in Michigan, PA 72, dating

1 from 1939, and the law refers to the 1898 Bankruptcy Act and
2 basically says that any taxing agency or instrumentality as
3 defined in the bankruptcy law may proceed to do something
4 called secure a composition of its debts, and the law then
5 goes on to describe rules about who can file the petition and
6 who can agree to the plan of composition and what kinds of
7 things can be in the plan of composition and also provides
8 that the composition is binding on the instrumentality.

9 In 1963 -- okay. So that's the law that's on the
10 books. In 1963 as well the municipal bankruptcy law that is
11 being referenced looks a lot more like the '37 law than it
12 does the law that we have today. On the sort of time line of
13 Chapter 9 changes starting with the law that was declared
14 constitutional by the Supreme Court in '37, while there are
15 some changes that take effect in 1946, you really don't get a
16 major overhaul until 1976 and the events surrounding the New
17 York City fiscal crisis, so from that point forward -- from
18 that amendment forward, Chapter 9 looks a lot closer to the
19 Chapter 9 that we're dealing with today, but in 1963 it
20 really didn't look like that. And, frankly, the notion
21 that -- and this is where we get to the pension regime part
22 of my answer. The notion that the pension clause coming in
23 as it did to take a situation where employees working for the
24 state had, in effect, no vested right to deferred
25 compensation they had earned with services that they provided

1 to the state, that was -- that's the gratuity and the gift --
2 that changes with the pension clause, which then provides the
3 protection for accrued financial benefits. This is a new
4 thing under the state Constitution. So it's not -- to me
5 it's not surprising at all that you wouldn't find a reference
6 to the plan of composition or municipal bankruptcy because we
7 have really these arcane terms that it is very unlikely
8 anyone would have applied to vested pension rights. It's not
9 until 11 years later that ERISA is enacted in the federal
10 regime. ERISA, of course, has language -- sets forth a
11 comprehensive scheme to protect pensions and uses words like
12 "nonforfeitable benefits" and "vested pensions" and "accrued
13 pensions" and the like. And as we talked about last week,
14 that regime includes the pension termination system, and you
15 get then developing in the private sector bankruptcy world,
16 the Chapter 11 world, the Chapter 7 world, where the
17 priorities do function, what is the status of a pension
18 contribution given the fact that it is based on services that
19 were rendered to the debtor pre-petition? All of that law
20 comes up after 1963. There just simply wouldn't be a way to
21 think about a pension benefit in the context of a debt
22 composition, or at least that is -- that seems very likely to
23 me because you just don't get this law -- all of this law
24 coming up until you get to ERISA and the concept of plan
25 termination and the priorities that apply in Chapter 11 and

1 Chapter 7 years and years later. And now, you know, to my
2 way of thinking about it, unfortunately, we have seen a lot
3 of pension terminations, and so there's a lot of law on that
4 subject now, but it didn't exist in 1963, and it couldn't
5 possibly have been fairly contemplated. So I think that
6 we're then left with a section, which is the pension clause,
7 Article -- of the pension clause of the Michigan Constitution
8 that is very much standing on its own without reference to
9 any exception, and we can see why, I think, no -- in
10 particular no reference to the concept of municipal
11 bankruptcy working very much, in effect, each word being
12 given effect by the courts of Michigan who have construed it
13 a number of times to protect accrued pensions. And it's
14 standing on its own effectively against impairment or
15 diminishment by, as we spoke about last week, the state, the
16 state officials, or governance -- government and political
17 subdivisions to which it applies, so I think the --

18 THE COURT: I have to interrupt you and ask this
19 question about bankruptcy. Is there anywhere else in the
20 Bankruptcy Code where a party's nonbankruptcy law right to
21 payment is given an absolute status in the bankruptcy?

22 MS. CECCOTTI: Well, your Honor, I think that there
23 are a number of places in the Bankruptcy Code where state law
24 is referenced, and we had a reference to the effect given to
25 certain types of liens, which are given effect, but I think

1 the --

2 THE COURT: Well, but even there there are many
3 circumstances in which security interests are not given
4 absolute effect in bankruptcy.

5 MS. CECCOTTI: Your Honor, here's --

6 THE COURT: Cramdown, of course, is a perfect
7 example of that.

8 MS. CECCOTTI: Here's where I think the crux of this
9 is. We have a regime in Chapter 9 that must operate by
10 maintaining the state's sovereign control over the political
11 and governmental affairs, including the expenditures
12 therewith under 903. Chapter 9 is not Chapter 11, and so,
13 therefore, the question to start with is what is the -- what
14 limited things can be done in Chapter 9, not necessarily
15 let's look at the whole of the Bankruptcy Code and try to
16 sort of plug in examples that are going to cross between a
17 Chapter 9 debtor and a Chapter 11 debtor.

18 THE COURT: I understand that argument, but isn't
19 the end result of that argument that a state like Michigan
20 that has this clause, if it is to be given absolute impact,
21 cannot authorize its municipalities to file bankruptcy?

22 MS. CECCOTTI: Cannot authorize its municipalities
23 to file for bankruptcy if a purpose is to diminish or impair
24 accrued pensions. That's correct, and that is --

25 THE COURT: But what you're not saying there is that

1 if there is the intent not to diminish pensions, they can
2 file municipal bankruptcy?

3 MS. CECCOTTI: In this case, your Honor, the intent
4 was made abundantly clear going in. If they had hidden the
5 intent, we might --

6 THE COURT: No. I understand that. I'm trying
7 to --

8 MS. CECCOTTI: -- we might not be standing here
9 today.

10 THE COURT: I'm trying to figure out where your
11 argument goes because there are two possible outcomes here.
12 One is when a municipality is subject to the state
13 constitutional provision, it can file bankruptcy and still
14 impair, or it can file bankruptcy without the intent to
15 impair, or I suppose there's a third alternative, which is
16 the one I'm asking about, which is they can't file bankruptcy
17 because bankruptcy doesn't permit that kind of
18 discrimination.

19 MS. CECCOTTI: I think -- your Honor, I think it's a
20 false choice, frankly. I really do. And we've seen some --
21 we've seen enough instances, I guess, of the more modern use
22 of Chapter 9, particularly the cases out in California,
23 where -- and this is -- and CalPERS has been just on the
24 forefront of this, as I'm sure you know -- where they're not
25 touched. I just -- I don't see what is so accepted or that

1 it's a black and white choice between filing for bankruptcy
2 and not filing for bankruptcy simply based on the pension
3 question. I mean this is a -- this is a very -- this is a
4 large, large municipality to be seeking Chapter 9 relief.
5 There is a lot going on. This very much reminds me, Judge,
6 of going from the very small Chapter 11's at the beginning of
7 the '78 Code and then all of a sudden finding companies like
8 LTV Steel filing for bankruptcy and suddenly declaring that
9 retiree health was a general unsecured claim, someone no one
10 had thought of before. This very much feels to me like that
11 type of a moment where the size of this city and the
12 magnitude of what it's trying to accomplish simply cannot be
13 easily fit within the rules that might otherwise apply in a
14 smaller -- in a smaller context or with less going on or with
15 less money available for fewer options. It's very much a
16 moment, I think, where -- it's one of those moments that I
17 think we will look back on and say this is where Chapter 9
18 changed. And we are very much hoping it does not change in
19 the direction of violating what we believe are legitimate --
20 a legitimate basis for a municipality to say, "I need to
21 adjust my debt, but I am going to adhere to a state law, a
22 state constitutional provision like the pension clause, and I
23 can accomplish both." I very much think that those things
24 are possible, and if we don't have a bankruptcy system that
25 allows for that duality -- the dual sovereignty to have play

1 like that, then we are simply wiping aside centuries of
2 constitutional law. And I'm really -- my colleagues are
3 going to be very upset with me.

4 THE COURT: Eleven minutes left.

5 MS. CECCOTTI: I'm sorry.

6 MS. PATEK: Your Honor, given the time
7 limitations -- again, Barbara Patek on behalf of the Detroit
8 Public Safety Unions -- I want to address for the moment the
9 Court's question about whether there's anywhere else in the
10 Code, and I don't -- I believe the answer to that question is
11 no, but I think also the Tenth Amendment answers that
12 question. And I think even if you assume for the sake of
13 argument that there are -- that what the -- what is being
14 said here, that this is just a priority issue, that this
15 constitutional promise that was made to these public servants
16 is to be treated like general unsecured debt as if it were
17 credit card debt, I think a careful look at the Code answers
18 that question to the contrary, and I think you can start with
19 the Orange County versus Merrill Lynch case, which talks
20 about 507 and the reason for the exclusion of (a)(1) and
21 (a)(3) through (9) from the Code. And in a footnote it talks
22 about what were then (a)(3) and (a)(4) being excluded because
23 they had to do with employment rights and collective
24 bargaining agreement rights potentially of employees which
25 could affect the ability of the municipality to continue its

1 operation. I suggest it's no accident that those two
2 sections were excluded. I suggest that it's no accident --
3 we heard a lot about electoral will or political will last
4 week -- that this provision is tucked away in the Michigan
5 Constitution so it's difficult to change. This is a promise
6 that's made to people as part of the sovereignty of the State
7 of Michigan to the people who are necessary in this case,
8 talking about my clients, the Public -- the members of the
9 Public Safety Unions, and I would suggest that it would be a
10 violation of the Tenth Amendment to read the Code otherwise.
11 Thank you, your Honor.

12 MR. MONTGOMERY: Your Honor, Claude Montgomery for
13 the Retiree Committee. I had four things that I was going to
14 try to address today in my seven minutes. One was ripeness.
15 One was whether or not there is an issue, despite the Cardozo
16 dissent, and, three, I'd like to answer the question of
17 whether or not intent matters for the governor and the
18 emergency manager, a question raised by the state, and,
19 finally, if I have any time left, that Studier does not
20 undercut Seitz v. Probate Judges System.

21 But I'd also like to take the opportunity to answer
22 the last question or at least offer a thought -- whether or
23 not it's considered useful or not, I will, of course, leave
24 to the Court -- and that Bekins itself tells us what the best
25 interest question was, and it wasn't relative treatment of

1 creditors. It was whether or not bondholders could get tax
2 people to actually levy on property that was either worthless
3 among the municipalities or couldn't be sold for the amount
4 or tax levy marshals and whatnot were running away from
5 creditors. So the best interest of creditors that Bekins saw
6 being made possible by the plan of adjustment was better than
7 zero, not a relative priority vis-a-vis other creditors but
8 an ability to get paid where the state was actively, through
9 its minor officials, resisting paying anything. And so I
10 think that is the best interest of creditors that 943(7) is
11 looking to, and I have further statutory construction for
12 that. At least I offer it. One is that neither 1129(a)(7)
13 nor 1129(a)(11) are actually adopted by Chapter 9, and so
14 the -- what is the best interest of creditors as in feasible
15 is not necessarily identical to those statutory -- those two
16 statutory provisions to which no reference is made.

17 So now I'd like, if you will, turn my attention to
18 the Cardozo dissent, which I must say I thought Mr. Bennett
19 made a very interesting offer to the Court as a foundation
20 for Bekins, but I would like to suggest and only suggest,
21 your Honor, that there is a key -- two key parts to the
22 Cardozo consent that the Court may wish to pay attention to.
23 One is that the Court action on which Mr. Bennett relies was
24 the discharge of the debt. It wasn't what happened inside
25 the plan process. It was the actual discharge, which

1 couldn't be accomplished without court intervention. The
2 second thing that was critical to Justice Cardozo's thinking
3 and, according to Mr. Bennett, ultimately adopted by the
4 Bekins court, which was this concept of consent. Well,
5 Justice Cardozo characterized it as a waiver of a privilege,
6 right, but here what controls how the state exercises the
7 waiver of the privilege? Well, obviously that has to be a
8 question of state law. It can't be transformed into a
9 question of federal law. And what is the state law that
10 controls the exercise of the waiver of the privilege? Well,
11 it's this Michigan state Constitution. So if the Michigan
12 state Constitution is the bedrock on which the waiver takes
13 place and the Michigan Constitution says, according to the
14 Seitz case and according to the Musselman case, no act can be
15 taken that results in a diminishment of pensions, not affects
16 the value of those pensions but actually diminishes the
17 amount of those pensions, then the state actors cannot do
18 anything in that regard. And I would further answer the
19 question your Honor asked earlier, was if the Michigan
20 Constitution is a proscription on the behavior designed to
21 undercut the Constitution, does that mean that no city can
22 file a Chapter 9? Well, obviously ones that don't have
23 pension issues don't even have to ask the question, so 436
24 and the Michigan Constitution are clearly not a bar where
25 there's no desire to impair pensions because they don't have

1 pensions, but if they do have pensions --

2 THE COURT: Well, I'm not sure that's so.

3 MR. MONTGOMERY: Well, as your Honor -- forgive me.

4 THE COURT: I mean my question would be in that
5 case -- I mean you can construct a hypothetical in which the
6 city proposes to impair bonds and the bondholders are saying,
7 "Wait a minute. There's this other asset over here, the
8 pension assets, you know. We have to impair everybody, not
9 just us."

10 MR. MONTGOMERY: I presume your Honor meant pension
11 obligations.

12 THE COURT: Pension, yeah. Thank you.

13 MR. MONTGOMERY: The one difference between the
14 state constitutional provision on impairment of contracts and
15 Article IX, Section 24, is that Article I, Section 8, of the
16 Michigan Constitution speaks of legislation whereas Article
17 IX, Section 24 --

18 THE COURT: And I don't mean to frame this in terms
19 of a constitutional protection for bonds because that's not
20 the point of it. The point of it is that the bondholders
21 could argue that under the Bankruptcy Code, pension holders
22 do have to be impaired, even if the municipality doesn't want
23 to, to achieve fairness in treatment.

24 MR. MONTGOMERY: Well, first, they would have to, of
25 course, start on a class basis because obviously --

1 THE COURT: Right.

2 MR. MONTGOMERY: -- the unfair discrimination starts
3 there, but, secondly, the key issue here for whether or not
4 there is an unfair discrimination is whether or not there are
5 differences in the protections afforded each claim. It is
6 well-established that you can make distinctions between
7 creditors based on the nature of the obligation and that you
8 can make differences in treatment based on the nature of the
9 obligation, so the only question is whether or not it's
10 unfair, and how could it be unfair to let the pension rights
11 of the City of Detroit retirees pass through a Chapter 9 case
12 if the Michigan Constitution says it's unconstitutional to
13 try to impair them?

14 THE COURT: The bondholders say protected by
15 Constitution or not, in bankruptcy they are unsecured claims.

16 MR. MONTGOMERY: Right. And so if, your Honor, the
17 only possibility of dealing with a pension obligation is that
18 it has to be done in a Chapter 9 and it is unconstitutional
19 for the actor, the state actors to ask for Chapter 9, I think
20 you're blocked. You can't ask for the Chapter 9 position.
21 And we find nothing inconsistent with that roadblock because
22 the people of Michigan retain the right and the ability to
23 change the law if they wish to give their municipalities
24 greater access to Chapter 9. If, in fact, Article IX,
25 Section 24, is a roadblock -- and we assert it is a

1 roadblock -- the people of Michigan, not the federal
2 government, but the people of Michigan retain the right to
3 make that change.

4 THE COURT: One more minute.

5 MR. MONTGOMERY: Yes, sir.

6 THE COURT: Ripeness. I would simply commend your
7 attention to U.S. Postal Service v. National Association of
8 Letter Carriers, which your Honor no doubt has read and which
9 ripeness focuses on the timing of the action rather than the
10 party that brings the action, and the key question there for
11 the Court was whether or not there was a reasonable threat of
12 liability if compliance with the arbitration order violated
13 the CSRA, which was the relevant statute, and we say the
14 analogy to that is whether or not there's a reasonable threat
15 of harm to the pensioners as a result of the city's action.

16 THE COURT: Um-hmm.

17 MR. MONTGOMERY: And I think that's -- at least we
18 would offer to your Court that is a difficult thing to
19 dispute. And I think that exhausts my ten minutes, your
20 Honor.

21 THE COURT: Thank you.

22 MR. SCHNEIDER: Your Honor, Matthew Schneider, chief
23 legal counsel, Michigan Department of Attorney General, on
24 behalf of the state. Your Honor, I'd only like to discuss
25 two topics here. One is home rule and then, secondly, the

1 referendum issues regarding PA 436.

2 So if we start with the home rule argument, if we
3 look at Article VII, Section 22, just setting aside the text,
4 we have to look at the text and ask what does this do. What
5 does this provision of the Constitution do? It gives local
6 citizens the power to adopt their own governing structure and
7 ordinances. And what it allows citizens to do is gives them
8 a City Council. The City Council can adopt ordinances and
9 resolutions. And the citizens have a right to that power.

10 In this case, what did the citizens do with that
11 power? Look at Detroit City Charter, Section 1-102. They
12 enacted as part of that charter a provision that reads,
13 quote, "The City has the comprehensive home rule power
14 conferred upon it by the Michigan Constitution, subject only
15 to the limitations on the exercise of that power contained in
16 the Constitution or this Charter or imposed by statute." So
17 the charter itself states that the home rule power is limited
18 to what is imposed by statute.

19 But even if it didn't say that, if the charter
20 didn't say that, we know that when the citizens of Detroit go
21 to the ballot box and they elect their City Council members,
22 those same members, those same citizens, have an opportunity
23 to vote for their state senator and their state
24 representative and their governor, and those representatives
25 in Lansing, who the city has an ability to vote for, pass

1 laws that govern those city residents as well. Those
2 representatives passed PA 436.

3 This cannot possibly violate the home rule concept.
4 Let's look at what those representatives did. They passed
5 the Home Rule City's Act, MCL 117.36. Quote, "No provision
6 of any city charter shall conflict with or contravene the
7 provisions of any general law of the state," unquote.

8 And we have to look at this through another third
9 and final prism. In 1963 the residents of this city had an
10 opportunity to vote another time, and they voted to ratify
11 the state Constitution. Article VII, Section 22, contains a
12 very important line that now binds those city residents. A
13 city, quote, "shall have the power to adopt resolutions and
14 ordinances related to its municipal concerns, property and
15 government, subject to the Constitution and law," unquote.
16 The law is passed by the legislature. In other words, you
17 can only pass local laws that are subject to the Constitution
18 and the laws passed by the legislature, and this is all about
19 representative government. This is how it works in our
20 constitutional republic. The city residents still govern
21 themselves. They voted for the people enacting the city
22 charter. The city residents voted for a legislature that
23 enacted PA 436, and the city residents had a hand in the
24 Michigan Constitution as well.

25 If you look at the legal priority here, we know, as

1 I've stated, that the acts of the legislature can take
2 priority over local acts. The Michigan Supreme Court in Mack
3 v. City of Detroit, 467 Mich. 186, a 2002 case, explained
4 this. There was a Detroit city charter provision that
5 created a private cause of action for discrimination. A city
6 police officer brought a discrimination suit under the
7 charter, but in this case the legislature had already passed
8 a governmental immunity statute that prevented these actions
9 against the city. And the Michigan Supreme Court held that
10 the charter provision conflicted with the law as passed by
11 the legislature, and so the legislation took priority over
12 the charter.

13 PA 436 is not a local act. It can be applied to any
14 other city, and we can see in the newspapers today about the
15 issue of PA 436 being raised in other cities or
16 municipalities. So there's a much larger point here, your
17 Honor. The objectors, I think, are incorrect in the overall
18 approach to the home rule argument. They're arguing that PA
19 436 trumps home rule and ignores the will of the voters and
20 that the legislature somehow just wanted to overrule the
21 citizens of Detroit, but we have to look at PA 436 and know
22 that there were incredibly compelling reasons for PA 436.
23 The point of that, as spelled out in the Act, was to help
24 distressed cities and school districts. The evidence showed
25 that this was a problem that was not going away. It was true

1 before PA 4, after PA 4, before PA 436, and after it. And
2 the language of PA 436 shows that the legislature wanted to
3 fix it, but it also responded to the voters' rejection of PA
4 436. If we look at the governor's testimony in his
5 deposition, he indicates as such.

6 THE COURT: Well, but the fact that there may have
7 been compelling reasons for 436 wouldn't justify it if it's
8 otherwise unconstitutional, would it?

9 MR. SCHNEIDER: No, but there's no -- it's not
10 unconstitutional. That's my point.

11 THE COURT: I'm just wondering why you're arguing
12 that it was compelling. What's the point?

13 MR. SCHNEIDER: It's a point because -- just to say,
14 your Honor, there's a much larger point here, and the point
15 is is this wasn't done arbitrarily. This was done for a very
16 specific purpose.

17 Secondly, your Honor, I want to respond to the issue
18 regarding the right to referendum. I believe Assistant
19 Attorney General Margaret Nelson explained this quite
20 adequately yesterday, but I do want to address the fact that,
21 you know, there's been argument raised here that there were
22 documents produced in discovery that lawyers at Jones Day
23 discussed how PA 436 would be, you know, going around the
24 referendum power. Well, neither of these people were members
25 of the legislature. If we look at the governor's position

1 itself, the state has produced discovery in this case
2 explaining the governor's position, and it was not to go
3 around the legislature. The governor had directed -- I
4 believe it was Dick Posthumus, the former lieutenant
5 governor, and his legislative director, how are we going to
6 craft -- how would PA 436 be crafted? It would be crafted
7 not to ignore the will of the voters. It would be crafted in
8 order to make sure that different changes were made to make
9 it better. And, you know, as to --

10 THE COURT: But how does anyone know whether the
11 changes that 436 incorporated over the rejected law, PA 4,
12 responded to the will of the voters or not? How does anyone
13 know that?

14 MR. SCHNEIDER: Well --

15 THE COURT: I mean all we know is PA 436 was
16 repeal -- PA 4 was repealed.

17 MR. SCHNEIDER: Folks aren't blind, I think, to the
18 media coverage as well. When an act is --

19 THE COURT: Rely on media coverage?

20 MR. SCHNEIDER: Well, they have constituents. Laws
21 are passed only through the regular process of legislators
22 responding to their constituents, and that is the will of the
23 voters. And when the governor wants a new structure, PA 436,
24 or the members of the legislature want that, their
25 constituents will go to the media as well or will speak

1 directly to them, so it was in direct response to fixing the
2 problems that the will of the voters pointed out.

3 If you have any other questions on these topics, I'd
4 be happy to answer them or I could defer to Mr. Bennett on
5 the other issues.

6 THE COURT: Thank you, sir.

7 MR. SCHNEIDER: Thank you.

8 MR. BENNETT: Good afternoon, your Honor. Bruce
9 Bennett of Jones Day on behalf of the city. I got a little
10 bit of an organizational challenge here. One comment with
11 respect to the last point concerning the right of referendum,
12 if the defect in 436 is that there was a right -- there
13 should have been a right to referendum anyway,
14 notwithstanding what the statute says, well, I suppose the
15 remedy is for someone to try to mount a referendum, not to
16 wait till you come to a Bankruptcy Court and ask the
17 Bankruptcy Court to decide there should have been a
18 referendum. If there had been a referendum, it would have
19 been rejected, and, therefore, we're going to hold it
20 unconstitutional. It seems that there's a whole -- there's a
21 few steps that are being skipped in the relief that's been
22 requested of you here.

23 There's a number of topics, and I can only refer to
24 the other Mr. Bennett to cover all the different questions,
25 so I'm going to try to organize it, but if it falls apart a

1 little bit, I apologize.

2 First, there was an appeal to the other California
3 cases, which has to refer to Vallejo, where, of course,
4 pension claims were not impaired, debt claims were impaired,
5 in what was a largely consensual plan. I think I said in
6 another appearance before this Court that today Vallejo may
7 well be in trouble again and perhaps because it did not get
8 enough relief from its debt generally, but that's not the
9 reason I refer to it this time because I think you can't
10 refer to Vallejo without referring to Central Falls in Rhode
11 Island. And in Central Falls in Rhode Island, what happened
12 was was that the pension claims, pension and benefit claims,
13 took haircuts and the debt did not, again, a consensual
14 outcome.

15 If the economics were a little different, perhaps we
16 could have a consensual outcome one way or another in
17 Detroit's case, but I'm pretty sure that the bondholders, who
18 I think are listening on the phone and not here today, would
19 say that they are not in a position and would not consent to
20 allowing pension claims in this case to be unimpaired, and
21 I've certainly heard the various representatives of those
22 holding pension and other retiree benefit claims here and
23 indicating that they're not in a position or willing to let
24 bondholders leave unimpaired. And it may well be that this
25 is the first case where irrespective of consent from one side

1 or another, we could not achieve that result, so I think
2 the -- that a consensual outcome could come out differently
3 and could come out with only part of a capital structure
4 being impaired unfortunately says nothing about the
5 controversy we have today.

6 The second point I want to cover is the point about
7 the discharge language in Bankruptcy Code Section 944. It's,
8 of course, important whenever reading a provision in a
9 statute to figure out where it is in the statute, and the
10 provision relating to discharge is in the effect of a
11 confirmation order. And the line is that the discharge
12 applies -- excuse me -- the debtor is not discharged --
13 there's a broader discharge provision that comes ahead --
14 from any debt exempted from discharge by the plan or order
15 confirming the plan. This is not a claim that has some
16 inherent nondischargeability. This is a reference to a plan
17 exempting from the provision before it, and I suppose that
18 what this is intended to do is to say that obligations as
19 modified will continue if the plan or the order confirming
20 the plan says so. Otherwise, if you go up and look at the
21 discharge, it covers all claims, period, and so I think this
22 is a provision that makes a plan that partially and does not
23 fully discharge claims work, and I think that's all it is.
24 It's not a recognition --

25 THE COURT: Well, but what Mr. Gordon argues, if I

1 understand it correctly, is that this provision of the Code
2 allows a municipal debtor to waive the discharge of the
3 claims of a class, and, therefore, this city can pursue a
4 Chapter 9 case that addresses all of the debt other than the
5 pension debt which can't be pursued or at least impaired
6 because of the Michigan Constitution.

7 MR. BENNETT: Well, once again, this provision is
8 one section in a Bankruptcy Code that contains lots of other
9 sections, and a couple of them were touched upon by your
10 Honor and other people addressing you just a few minutes ago.

11 First, there was a discussion about whether it
12 creates a priority or not. I don't think that's terribly
13 relevant. The issue that the Bankruptcy Code sets up is that
14 it has a distribution scheme imbedded in it. The
15 distribution scheme in some places is given effect through a
16 combination of a declaration that a particular claim has
17 priority and then a treatment requirement that you would find
18 in 1129. In others there's no explicit priority, but there's
19 a treatment -- there's a treatment requirement in 1129, and
20 that treatment requirement works two ways, and I think this
21 came out in the discussion. One, there's the ranking, which
22 is basically what 1129(b) does between secured claims,
23 unsecured claims, subordinated claims, and not in Chapter 9
24 equity. But it also has the nondiscrimination provisions,
25 and I actually think that counsel for the retiree committee

1 slightly misspoke when he said, well, nondiscrimination,
2 that's an issue between classes, and it is, but within
3 classes there's actually a stronger nondiscrimination
4 provision. The treatment within a class has to be the same.
5 Between classes the rule is unreasonable discrimination. And
6 so the discharge -- the provision in 944, the ability to have
7 an exception in the confirmation order from discharging all
8 claims that existed on the petition date and leaving some
9 around to some extent, I don't think is a license to confirm
10 a plan that doesn't meet with the requirements of 1129, both
11 the priority -- what I called priority, but the
12 distributional entitlement requirements and the creditor
13 justice requirements, whether they are unlawful
14 discrimination or same treatment within a class. And so you
15 get to the point where your Honor was, I think, which is that
16 these claims are --

17 THE COURT: Well, but Mr. Morris pointed out
18 astutely that Chapter 9 itself prohibits -- or I should say
19 requires that a plan be fair and equitable. Yes?

20 MR. BENNETT: It has a different meaning than the
21 provision in the Chapter 11 --

22 THE COURT: Right.

23 MR. BENNETT: -- for -- yes.

24 THE COURT: Right.

25 MR. BENNETT: But he referred to best interest, but,

1 yes, it has a fair and equitable provision.

2 THE COURT: So he argues how can a provision that
3 impairs pensions be fair and equitable in the face of the
4 constitutional protection of them?

5 MR. BENNETT: I think you go back to the -- again,
6 what came up when we were last here, which is that you can
7 say as a constitutional matter these cannot be impaired for
8 one -- by the municipality, but the reality is at the end of
9 the day there isn't enough money. And when the reality is
10 there isn't enough money to pay them, then if you went
11 through all and exhausted all of the nonbankruptcy procedures
12 for enforcing a debt, where would you be? That is the --
13 that is essentially the best interest benchmark. And we've
14 got a lot of law on this. Bekins, which was referenced, is
15 one of them. The fact pattern that you see in cases
16 involving very distressed municipalities in the cases, which
17 a lot of them are from the depression era, of course, is
18 situations where the municipality, notwithstanding an
19 obligation to raise taxes, just can't collect any more money
20 no matter what it does. Sadly, that fact situation, albeit
21 with more modern features, presents itself in Detroit. And I
22 think it would be what the city will have to prove, open
23 paren, one, in the event it does not achieve a consensual
24 plan, which it still hopes to and that the -- that it is
25 object -- the plan is objected to by relevant constituents

1 representing retirees, the city will ultimately have to prove
2 that the distributions on account of underfunding claims
3 offered by the plan are better than the contributions that
4 could be achieved if there wasn't a Chapter 9 case and if the
5 creditors were free to pursue their remedies, all creditors
6 were free to pursue their remedies, and if the residents
7 reacted as we can predict residents would react because they
8 have been doing so for the past several decades. And if the
9 city -- if the retiree -- committees represented by the
10 retiree groups are able to prove that the environment for
11 them outside of Chapter 9 is better than the results we are
12 able to achieve in this Chapter 9 case, they may get a chance
13 to prove to themselves whether they were right or wrong
14 because that's where we'll be. We'll be in a dismissed case.
15 There will be lots of unsatisfied bond debt. There will be
16 lots of unsatisfied pension debt. There will be lots of
17 unsatisfied OPEB debt, and we'll see how it turns out. I
18 think that will not be a good outcome.

19 So this kind of brings me back to how the system
20 works, and I think, frankly, why don't I start with really
21 Justice Cardozo's reasoning? And first I wanted to spend a
22 minute to take away some of the mystery that seems to be
23 surrounding who was where in 1936 and 1938. It was mentioned
24 that Judge Cardozo for some reason didn't participate in the
25 decision in Bekins. Unfortunately, that's because Justice

1 Cardozo had a heart attack at the end of 1937, a stroke at
2 the beginning of 1938, and he died in early July 1938, about
3 ten weeks after the decision in Bekins. The reality was is
4 Justice Cardozo was too sick to participate. His opinion was
5 joined by, quote, the chief justice, Justices Brandeis and
6 Justice Stone -- excuse me -- Justices Brandeis and Stone. I
7 actually didn't know when we were here last for certain that
8 the chief justice at the time of the dissent was the same
9 Chief Justice Hughes who wrote the opinion in Bekins. It
10 turns out he was. I was able to verify that during the
11 break. And I think I offer what Justice Cardozo had to say
12 because its logic is irrefutable. By the way, its reasoning
13 wasn't assailed by any of the retiree representatives. It's
14 joined by a very distinguished group of justices, and all of
15 them except for Cardozo participated in the ultimate reversal
16 of Ashton in Bekins. The opinion, of course, was written by
17 Hughes, who joined the dissent, and I think, therefore, it's
18 an excellent aid to interpretation.

19 I admitted last time that Bekins is a little hard to
20 interpret because it's dealing actually with three specific
21 constitutional challenges. It spends most of its column
22 inches on the Article X problem. It spends exactly one
23 column inch on the Fifth Amendment problem and really only
24 talks about the commerce clause problem because the
25 legislative history that it quotes for the changes made

1 between Ashton and Bekins touches on the commerce clause
2 issue, and the Court basically is agreeing with the treatment
3 that accompanied it -- accompanied the statute in the
4 legislative history.

5 It turns out that Cardozo didn't write on a clean
6 slate. He cited a case, Imperial Irrigation District, 10
7 Fed. Supp. 832, which is probably where he borrowed the
8 concept, and I quote from that case, "The impairment of
9 contracts is brought about by the national law, and not by
10 the state measure, and local consent similar in effect to
11 that sanctioned by the California statute." The judge in
12 that case -- so it's obviously a district judge -- it's not
13 even an appellate judge -- is dealing with the same problem
14 that you would have if you tried to ground the
15 constitutionality of the Bankruptcy Court -- Bankruptcy Code
16 as against the contracts clause on anything other than the
17 reality that it is the federal power that is impairing
18 contracts. You wind up with a situation that you have
19 basically destroyed Chapter 9 and maybe parts of Chapter 11
20 as an avenue for impairing contracts in many circumstances,
21 not just pensions.

22 In short, you've proven too much. You've proven
23 that contracts clauses in every state -- and I said last time
24 I think there's a contracts clause in every state
25 Constitution, but I could be off by one or two -- that would

1 prevent the impairment of bonds. That would prevent the
2 impairment of trade claims. In fact, you would have
3 effectively preempted all impairments, and Chapter 9 would be
4 completely a dead letter. And so we have to look for other
5 interpretations or we should be looking very hard for other
6 interpretations, and we don't have to look very far. And as
7 I said before, I think while Bekins says -- crunches it into
8 a couple of sentences, Justice Cardozo's reasoning joined by
9 Hughes, Stone, and Brandeis explains to us why,
10 notwithstanding the federal contracts clause, notwithstanding
11 state contracts -- state Constitution contracts clauses, and
12 notwithstanding the pension clause, we still have an
13 effective bankruptcy power to implement debt restructurings
14 and debt impairments in cases where there are necessary --
15 where they are necessary. Nothing about eligibility is
16 dealing with the question that your Honor sensibly asked,
17 which is, "Don't you have to show that a plan is in the best
18 interest of creditors?" Clearly we do. Is there anybody
19 going to use Chapter 9 as a method for impairing contracts if
20 they're not in financial extremis? No, they should not, and,
21 no, they will not. It is in those circumstances where the
22 federal government comes to the aid of states and
23 municipalities that can't on their own restructure their
24 financial affairs.

25 And by the way, a nice corollary of looking at it

1 this way is that it dovetails precisely with one of your
2 Honor's observations, which is the last word -- I think it's
3 the last word of the relevant sentence of the pensions
4 clause, the words "thereby," which relate back to the state,
5 relate back to the municipality, but don't say that they
6 can't be impaired by anybody, just says the pension --
7 accrued pension benefits cannot be diminished or impaired
8 thereby, "thereby" being the state and the municipality. So
9 adopting the language and approach in the California case
10 just cited, in the Cardozo dissent joined by the other
11 justices, and in Bekins itself, albeit not quite as
12 precisely, you wind up with federal law that happens to fit
13 nicely with the actual language of the state law with a
14 bankruptcy system that does still work and has not been
15 crippled and made unable to deal with every financial --
16 every municipality in financial distress and a Bankruptcy
17 Code that is constitutional, as Bekins said it was.

18 I don't think I have many more points. First, I
19 wanted to make clear -- someone mentioned that the city had
20 not in oral argument taken positions on certain points
21 relating to PA 436. We've been relying and join in the
22 arguments of the attorney general. I think I dealt with
23 that. Oh, there was an assertion that the 1963 bankruptcy
24 law was somehow different than the fact that throughout --
25 beginning in the '30s but all the way through '61, '63, all

1 the way up until the Bankruptcy Code made specific
2 authorization unnecessary for awhile, Michigan authorized all
3 of its municipalities to resort to the composition law. This
4 1963 law still had impairment of contracts as one of its
5 central elements. In fact, if you look at Bekins, which
6 stands, of course, for many things, Bekins is a case where
7 it's a 60-percent -- it's a 60-cent distribution on account
8 of debt, and it was a mercifully simple case. There was one
9 class, so we didn't have to deal with discrimination and all
10 those other things. But Bekins is a debt impairment case.
11 It turned out to be that 86 percent of the creditors by
12 amount approved it, and it's the 14 percent who are
13 complaining. And so it really isn't fair to say that the
14 bankruptcy laws as they apply to municipalities were vastly
15 different than the laws that -- the laws that are here now.
16 They're probably a little bit more advanced in certain
17 respects, informed by the New York experience, but the idea
18 that contracts between a municipality or obligations of a
19 municipality because very often they're not just in the form
20 of contracts, they're in the form of ordinances, and its
21 creditors can be -- could be -- could have been in 1963 and
22 in 1961 impaired as a matter of federal bankruptcy law. It's
23 the absence of any mention at all of this issue or problem
24 anywhere in -- specifically in the pensions clause itself,
25 but also in the convention history leads to the conclusion

1 that people weren't thinking or it's hard to find any
2 evidence that anyone was thinking that anything that happened
3 in the structuring of the pensions clause was intended to
4 take Chapter 9 relief away from a municipality, period, in
5 any circumstances. And we think, again, that even if it did
6 or tried to -- and I think this is important -- even if it
7 did or tried to, the Justice Cardozo, Hughes, Stone, and
8 Brandeis reasoning would say it doesn't matter, that at the
9 end of the day, the -- unless there's an explicit direction
10 not to file Chapter 9, the state can only protect pension
11 claims so much. They can't protect them ultimately from
12 federal power.

13 I think those are all the points I need to cover.
14 If your Honor has any questions that I could answer --

15 THE COURT: No. Thank you.

16 MR. BENNETT: Thank you.

17 THE COURT: All right. Ladies and gentlemen, I
18 promised you one deliverable at the conclusion of these
19 arguments, which was a decision on whether or not there are
20 any genuine issues of material fact that should be addressed
21 at the upcoming trial relating to these issues which I had
22 preliminarily determined were strictly legal issues. I'm
23 going to take ten more minutes to just think about that. I
24 think there might actually be one. So we'll reconvene at
25 2:45. In the meantime, I want to remind you, please, that

1 when you are in the hallway, you must remain absolutely
2 silent, no talking in the halls. If you want to talk, you
3 can talk in here or down on the first floor.

4 One other housekeeping matter, which, again, I want
5 to bring up just in case I forget later. It was requested of
6 the Court permission to have in the courtroom a transcriber
7 to provide -- I guess it's called realtime transcripts, and
8 that's fine with the Court so long as we all understand that
9 that transcript is not the official transcript of the court
10 and may not be used in lieu of what would otherwise be
11 required to be used, the official transcript. So 2:45 we'll
12 reconvene.

13 THE CLERK: All rise. Court is in recess.

14 (Recess at 2:34 p.m., until 2:46 p.m.)

15 THE CLERK: Court is in session. Please be seated.
16 Recalling Case Number 13-53846, City of Detroit, Michigan.

17 THE COURT: Counsel are present. I want to
18 emphasize again what I think I stated the other day, that the
19 Court certainly will take into account in deciding these
20 issues which I have preliminarily determined are legal issues
21 any facts that come out in the trial that bear upon them.
22 Having said that, though, there is one issue of fact that
23 needs to be identified because the parties do disagree about
24 it, and it might have a bearing on one of these legal issues,
25 and that specific factual issue is what was the purpose of

1 adding the spending provision to PA 436.

2 Anything further for today? All right. We will
3 begin our trial at nine o'clock Wednesday morning in this
4 room. Oh, I urge you to get here early because the security
5 lines are longer at that hour in the morning than they are at
6 the times we've been starting.

7 THE CLERK: All rise. Court is adjourned.

8 (Proceedings concluded at 2:48 p.m.)

INDEX

WITNESSES:

None

EXHIBITS:

None

I certify that the foregoing is a correct transcript from the sound recording of the proceedings in the above-entitled matter.

/s/ Lois Garrett

October 23, 2013

Lois Garrett